

Avery Dennison Corporation (AVY)

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Company Description

The Avery Dennison Corporation (AVY) is a materials science and manufacturing company that specializes in the production of labels, functional materials, and packaging solutions. The company operates globally, playing an integral role in a wide variety of industries, including retail goods, healthcare, automobiles, and more. AVY takes pride in its focus on investment in emerging markets, its strong international presence, and its consistent development of environmentally sustainable solutions.¹

Though headquartered in Mentor, Ohio, the company currently operates in over 50 countries and employs approximately 36,000 employees worldwide. The size of the company's bottom line is predominantly attributed to international sources, as only 40% of sales come from domestic markets. The European market accounts for a similar share of sales, with just under 40% of sales originating from this region. The remaining portion of company sales largely comes from Asia, where a substantial part of AVY's manufacturing facilities are located.²

The firm's sales, profitability, and return on total capital have all exhibited consistent growth over the past five years. This result aligns with its shifting focus towards the development of both its highest revenue offerings and its most promising technologies. The company has demonstrated the effectiveness of its research and development efforts with a vitality index of almost 30%, indicating that nearly 30% of revenues are derived from newly developed products. Furthermore, internal reports reveal a high employee engagement score of 85%. The impressive figures observed in these progress and performance indicators have led to a total shareholder return exceeding that of the S&P 500 over the past five years, with a 170% increase in total market capitalization.³

The corporation's production responsibilities are divided into two distinct segments within the firm itself, each dedicated to the production and development of their specific offerings. This clear division within the company fosters greater efficiency in functionally different sectors without the threat of impediments arising from compromises or distractions among the various departments. The Materials Group segment, responsible for the vast majority of the company's sales, handles the production and distribution of labeling products, graphics, reflectives, tapes, and other adhesive materials, including those designed for medical applications. Of the approximately \$9 billion in annual revenue that the company earned in 2022, \$6.5 billion, or 72%, came from products offered by the Materials Group. This significant portion of company sales is a result of the Materials Group services being utilized in more established markets.⁴

The Solutions Group segment, which deals with more innovative products, manages the manufacturing and design process for information and branding solutions. Despite constituting a comparatively smaller portion of the firm's revenue, accountable for 28%, or \$2.5 billion, of sales, the Solutions Group has exhibited a relatively higher level of revenue growth with a 12% increase in sales over the past five years compared to a 6.3% rise in the Materials Group. Moreover, the Solutions Group has reported slightly higher profit margins than the Materials Group, with an adjusted EBITDA margin of 18.3% compared to a 15.1% adjusted EBITDA margin for the Materials Group.⁵

BUY

Current Price: \$171.09

Target Range: \$XXX.XX - \$XXX.XX

52 Week Lo: \$152.89

52 Week Hi: \$204.37

Market Cap: \$13.877B

Forward Div. & Yield: \$3.24 (1.89%)

52 Week Beta: 1.30

Founded: 1935

CEO: Mitchell R. Butier

Headquarters: Mentor, Ohio

Employees: 36,000



FactSet Research, June 2023¹

AVY Investor Presentation, May 2023²

AVY Investor Presentation, May 2023³

AVY Investor Presentation, May 2023⁴

AVY Investor Presentation, May 2023⁵

Company Description (cont.)

The higher growth and superior profit margins observed in the Solutions Group can be attributed to the segment's heightened focus on developing products and services in emerging markets. AVY's structured balance between growth in emerging markets and a sustained presence in developed markets has enabled the company to maintain profitability while expanding revenue opportunities from innovative products.

Beyond monetary and product growth, AVY has been lauded for its measurable commitment to social and environmental well-being. The firm's dedication to equitable employment is evident in an inclusion index of 85% and consistent growth in the percentage of female managers within the firm, rising from 32% in 2016 to 36% in the previous year.⁶ Furthermore, AVY is a recognized leader among manufacturing firms for its commitment to environmental sustainability. The company has not only declared its dedication to eco-conscious solutions, but its efforts are also quantifiable through AVY's substantially above-average environmental, social, and governance scores, currently standing at a short-term ESG score of 74/100.⁷

Industry Analysis

Although Avery Dennison's revenue streams span a multitude of diverse sectors, the company's expansive portfolio of products and services predominantly aligns with the broader containers/packaging industry.

Despite industry giants such as International Paper Company and Ball Corporation commanding large portions of the market, AVY has held its own amongst these strong competitors, securing a respectable 11% market share. Although it is a comparatively slower field, the containers/packaging industry has consistently shown moderate growth, with a 31% increase in value over the past 5 years, and an impressive 119% return over the span of the last 10 years.⁸

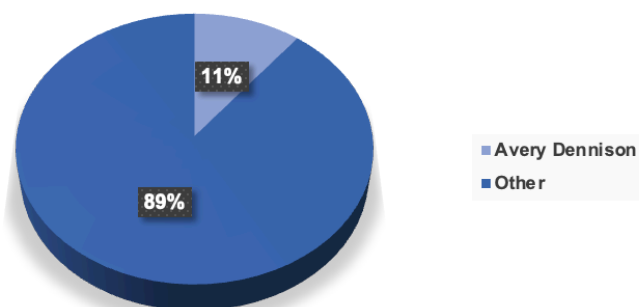
Over the last 12 months, the industry as a whole has recorded a price-to-earnings ratio of 12.2, potentially indicating relatively lower growth expectations. However, the containers/packaging market has also shown a price-to-book value ratio of 2.7, signaling that investors still have moderately optimistic expectations for growth in potential earnings. Beyond growth expectations, we can see characteristics of the consistent revenue nature in the industry with a price-to-sales ratio of 0.8. In alignment with the message derived from the previous price multiple, we see signals of solid cash flow stability, with a price-to-cash-flow ratio of 9.4.

Industry Analysis (cont.)

Furthermore, we see that firms in this industry have been able to contain increases in cost with a relatively small 3.5% capital expenditure growth. Additionally, this industry offers an attractive 2.7% dividend yield, which is higher than what is typically seen in the U.S. market as a whole.⁹

Looking past the financial statistics we can see a rise in the development and investment of various material related technologies. Products that have seen an upward trend in popularity within the containers/packaging industry are RFID chips, nanotechnology, graphene materials, and sustainably sourced products - all of which the Avery Dennison Corporation has committed research and development towards.

US Containers/Packaging Industry Market Share



	PACKAGING/CONTAINERS	U.S. Market
Return on Equity	21.7	15.6
P/E Ratio	13.0	20.1
P/B Ratio	2.7	3.7
P/S Ratio	0.8	2.1
P/CF Ratio	9.4	14.0
CAPEX Growth	3.5	1.5
Div. Yield	2.7	1.5

Product Mix

RFID: At the top of Avery Dennison Corporation's most promising products list is undoubtedly RFID technology. Designed with the intention to make the process of tracking goods more efficient, AVY's leading RFID technology has made the task of locating goods more feasible than ever before in environments once thought to be incapable of having such sound and sufficient infrastructure. Industries where AVY's RFID technology is currently employed include apparel, beauty, food, general retail, logistics, auto, and healthcare. The company has leveraged its existing relationships to

AVY Investor Presentation, May 2023⁶
 FactSet Research, June 2023⁷
 FactSet Research, June 2023⁸
 FactSet Research, June 2023⁹

Product Mix (cont.)

distribute approximately 40 billion units of RFID technology in the apparel industry, 10 billion in beauty, 10 billion in general retail, 60 billion in logistics, 5 billion in automotive, 10 billion in healthcare, and an impressive 200 billion in the food industry.¹⁰

Through these leveraged relationships and innovative solutions in this specific sector of goods, the Avery Dennison Corporation has commanded a remarkable 50% of the ultra-high frequency RFID market share.¹¹

Performance Polymers: One of AVY's most established product offerings are their performance polymers. Investing heavily in the quality of these products, working only with the most experienced scientific professionals, AVY has developed a wide array of performance polymers to be used in an equally diverse range of industrial applications. Businesses around the world rely on the company's four adhesive categories. These categories include solvent based, water based, UV cured acrylics, and rubber based hot melts.¹²

Yongle Tapes: One of the firm's largest holdings is the subcompany Yongle whose main offering includes innovative industrial tapes. AVY's investment in this product and company has proven to be advantageous as these high-quality products have been employed in a wide variety of industries. Avery Dennison Yongle's tapes are designed with technologically advanced ho-melt coating materials containing no solvent residue, and in accordance with sustainability efforts and fully safe for the health of humans working the material.¹³

Risk Factors

Supply Chain Problems: One of the biggest risks facing the entire packaging and containers industry as a whole is recent issues with manufacturing supply chains. Avery Dennison relies heavily on materials sourced from around the world to produce its intricate goods, and recent supply chain problems have hindered the scale at which it is capable of producing its various products.¹⁴

Sustainability and Environmental Regulations: Despite being a leader in the pursuit of generating sustainable solutions and sourcing environmentally conscious products, the implementation of stricter environmental regulations has still forced Avery Dennison to adapt to a changing manufacturing landscape. With impositions on costs through regulatory taxes introduced by both presidential administrations and legislative bodies, the firm and the industry have had to find ways to mitigate these rising costs without sacrificing quality or profits.¹⁵

Overdependence on Failing Retail and Apparel Industries: With such a large portion of Avery Dennison's revenue coming from its services geared towards the retail and apparel industry, the rise in brick-and-mortar establishments going out of business is a very real and legitimate concern for the company's revenue streams. If the company is not able and willing to pivot its offerings towards building relationships with more financially sustainable businesses, revenue streams are certain to decrease at an exponential rate.¹⁶

AVY Investor Presentation, May 2023¹⁰

AVY Investor Presentation, May 2023¹¹

<https://performancepolymers.averydennison.com/en/home.html>¹²

<https://yongletape.averydennison.com/en/home/technologies.html>¹³

<https://www.toolsgroup.com/blog/supply-chain-crisis-statistics/>¹⁴

<https://ceep.mit.edu/wp-content/uploads/2021/09/2012-013.pdf>¹⁵

<https://www.cnbc.com/2022/04/13/ubs-50000-retail-store-closures-in-us-by-2026-after-pandemic-pause.html>¹⁶

The aforementioned observations can be summed up concisely into the following SWOT analysis chart:

Strengths: <ol style="list-style-type: none"> 1. Global presence in a wide variety of industries. 2. Strong company values centered around social impact and environmental good. 3. Dedication to maintaining strong and efficient production of goods for established markets. 	Weaknesses: <ol style="list-style-type: none"> 1. Strong competitors holding substantially larger portions of market share. 2. Large portion of business depends on increasingly less profitable industries and retail sectors. 3. Historically slower growth industry relative to the market as a whole.
Opportunities: <ol style="list-style-type: none"> 1. Strong research and development on promising material technologies. 2. Growth in emerging markets on an international scale. 3. Investment towards long-term sustainable solutions in preparation for regulations. 	Threats: <ol style="list-style-type: none"> 1. Changing economic and financial landscape 2. Worldwide threats to supply chain efficiency and production. 3. Rising legal barriers on the traditional production practices of the form due to environmentalism.

Financial Ratio Analysis

	1YR (%)	3YR (%)	5YR (%)
Return on Asset	9.51	9.88	8.88
Return on Equity	38.27	41.01	39.57
P/E Ratio	19.65	22.55	24.26
P/B Ratio	7.20	8.39	8.43
P/S Ratio	1.65	1.89	1.67
P/CF Ratio	15.48	16.73	16.47
Current Ratio	0.99	1.10	1.1
Asset Turnover	1.14	1.18	1.25
Operating Profit Margin	14.67	12.26	11.93
Times Interest Earned	11.94	12.547	12.09

Valuation Analysis

Using the market value of debt and equity, the corporate tax rate, and the required rate of return of debt calculation we calculated WACC to be approximately 8.3%. We then calculated the DDM valuation of the model from the last dividend yield and the required rate of return on equity to be approximately \$218.63. Finally, to calculate the firm value using FCFF we used the long term growth rate, the cash flows from operating activities, the interest expense, and the CAPEX of the firm to evaluate it at \$198.02.¹⁷

The P/E ratio, EV/EBITDA, and EV/Sales are multiples taken from the last fiscal year of the firm and help contribute to the valuation of the firm.

Avery Dennison's FCFF valuation was calculated to be approximately \$198.02.

Avery Dennison's Enterprise Value to EBITDA (EV/EBITDA) ratio stands at 13.05, which may seem high when compared to the broad market but is quite reasonable within the US Containers/Packaging industry. A lower EV/EBITDA ratio could suggest a company is undervalued, but the industry average for the US Containers/Packaging industry is approximately 14.¹⁸ This implies that Avery Dennison is valued relatively cheaper than its peers, making it an attractive investment option.

Similarly, the company's Enterprise Value to Sales (EV/Sales) ratio of 1.94 shows that it could be undervalued when compared to its industry peers, which have an average EV/Sales ratio of around 2. Although it is not enough to strongly differentiate from other competitors, it is still a statistic to consider in the comparison between this company and similar ones.

An additional statistic that establishes how the company is undervalued is its value according to the DDM model. This model evaluates Avery Dennison at \$218.63 as of its present intrinsic value. Although this number is most likely not entirely accurate, due to the large gap between the current market price of the share of this firm and this valuation we can assume that this valuation is at least somewhat accurate. Compared to the current share price of approximately \$171 we can assume that the company is undervalued according to this model.¹⁹

Valuation Analysis (cont.)

Furthermore, Avery Dennison's Price to Earnings (P/E) ratio is 19.65, which might appear high when considered in isolation. However, when compared to the Containers/Packaging industry average of 20.1, Avery Dennison's P/E ratio suggests the company's stock is undervalued. In general, a lower P/E ratio might indicate that a company's stock is less expensive than its earnings would suggest, indicating a potential buying opportunity.

Another strong argument regarding this company's continual success was its unhindered success throughout the global supply chain struggle world wide. The company has numbers in comparison during the worst of those times, between 2021-2022, to current valuation numbers. The U.S. Containers/Packaging industry relies heavily on the health of the supply chain for movement of products significantly more than other industries, so for Avery to show promise even during the worst of these times proves their diligence and adaptability. Considering these factors and comparing Avery Dennison to its industry peers, the argument for purchasing Avery Dennison's stock becomes compelling. The company's strong cash flow, reasonable valuation metrics compared to the industry, and the potential undervaluation of its stock all indicate that Avery Dennison's stock is a sound investment opportunity.

Investment Thesis

Based on our in depth analysis of the Avery Dennison Corporation, financial standing, the firm's product offerings, their investment in innovative solutions, their involvement in sustainable sourcing, and the overall outlook of the container/packaging industry, we give AVY a 'buy' recommendation.

All of the potential threats that the company faces are easily overcome by simple diversification or changes in manufacturing. These necessary changes have already been exhibited by the corporation and have been expressed as one of their key missions moving forward.

Even though Avery Dennison operates within an industry with historically moderate growth trends, their commitment and diligence to research and development in emerging markets and new/trending technologies positions the firm in a strong place for future growth.

Beyond the promising operations of the company, the financial side has shown equally as appealing promise. With strong price multiples relative to the rest of the market and high valuations calculated through FCFF and DDM models, we anticipate Avery Dennison's share price to grow consistently in the coming years

FactSet Research, June 2023¹⁷
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